LIETUVOS BANKAS
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Lithuanian financial sector:

Contribution to economic growth and effectiveness

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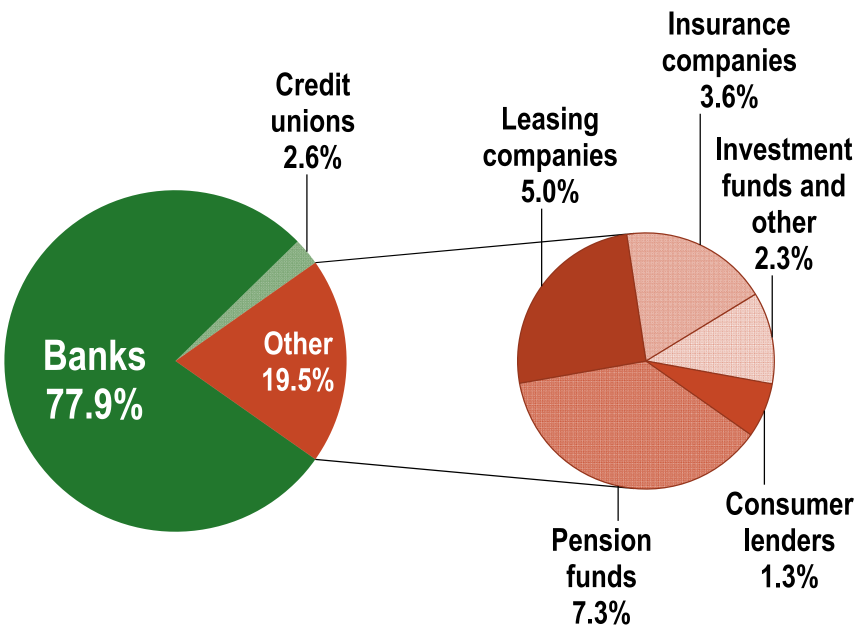
Outline

- Some stylised facts
- What does determine the size of the financial sector?
- Is there enough financing for Lithuanian firms?
- Credit impulse: credit impact on GDP

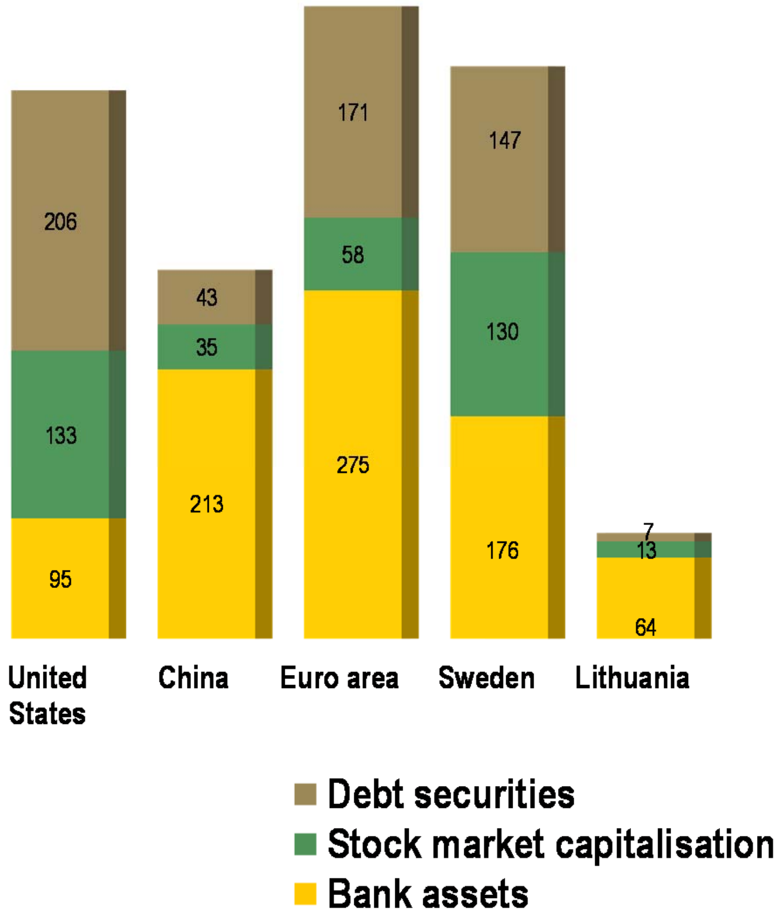
Bank-based financial system

Structure of financial institutions' assets in Lithuania



Source: Bank of Lithuania, 2015Q2.

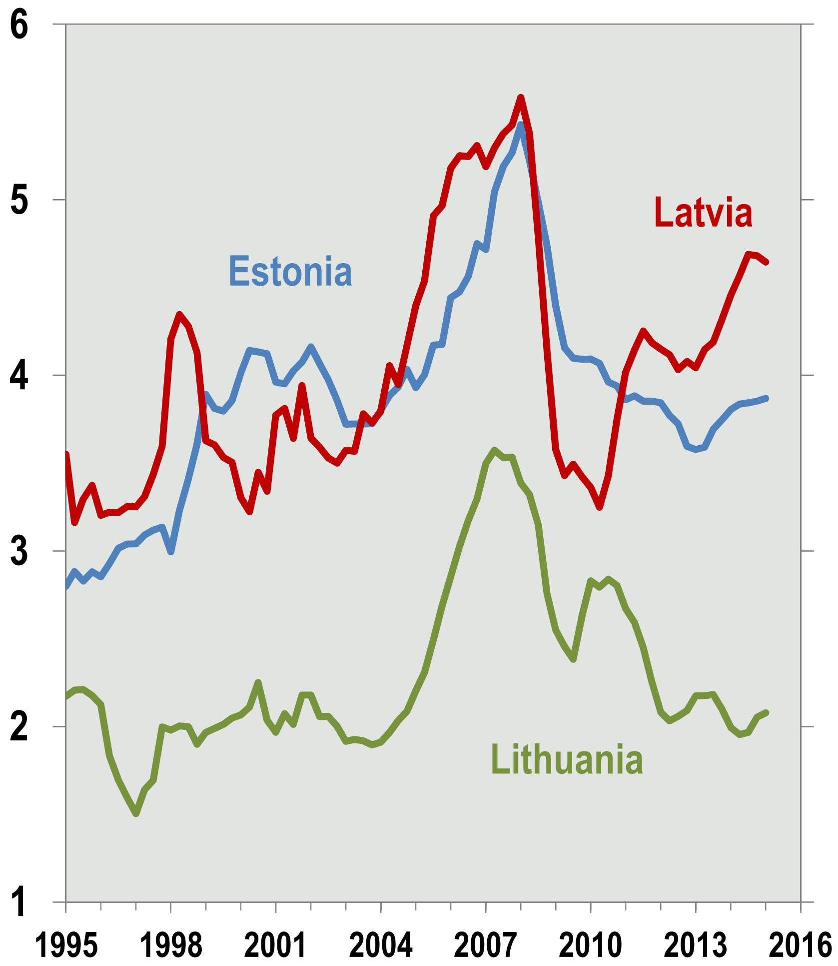
Bonds, equities and bank assets, 2013 % GDP



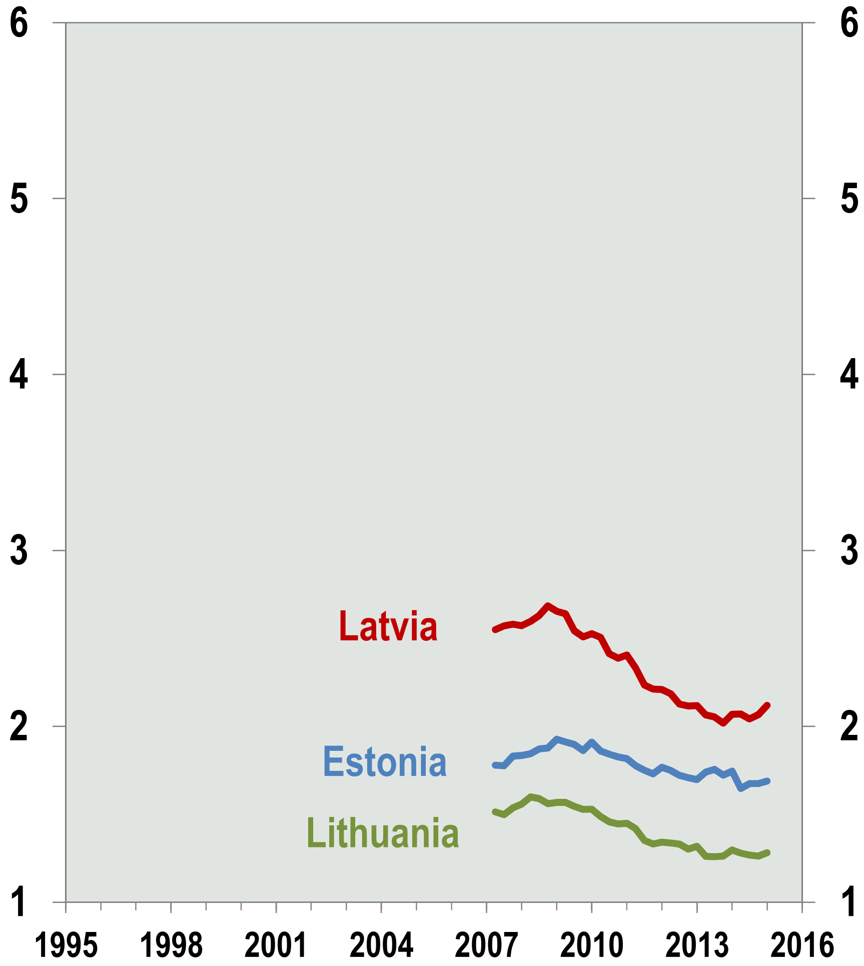
Sources: IMF GFSR and Bank of Lithuania.

Importance of financial intermediation

Share of financial intermediation in Gross Value Added (GVA), %

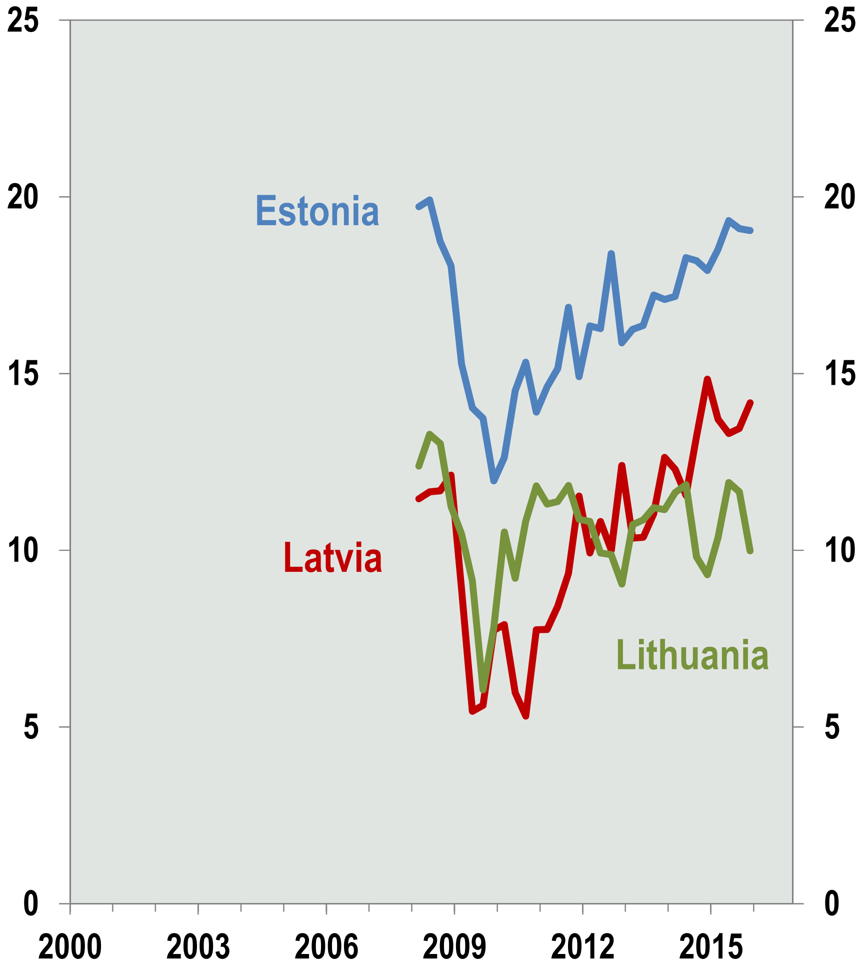


Share of financial intermediation in total employment, %

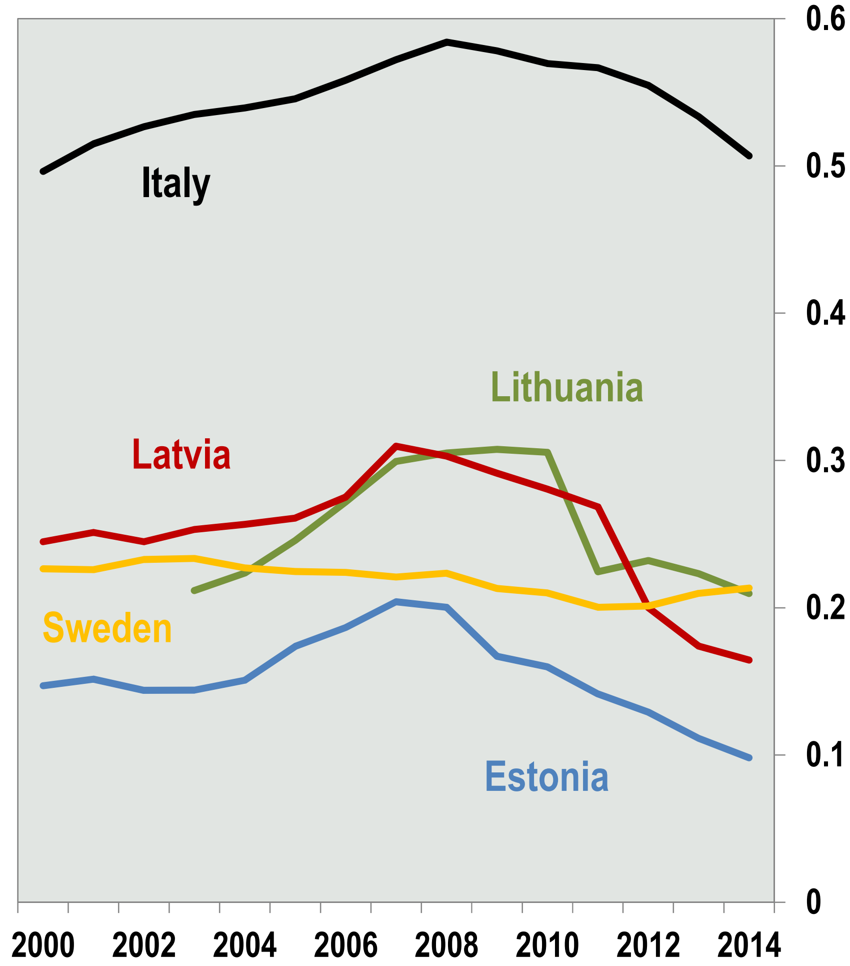


Efficiency of financial intermediation

Annual Gross Value Added (GVA) per employee, EUR thousands



Bank branches per 1000 inhabitants



Why are the sizes of financial sectors different?

- **Taxation !**

  affects demand for credit through the deductibility of

  - interest expenses for firms, i.e. 'debt bias' – yes
  - mortgage interest payments – abolished
  - reinvested profits – abolished

  subsidises the insurance sector through the deductibility of

  - investments in life assurance/pension products – yes

  in Lithuania

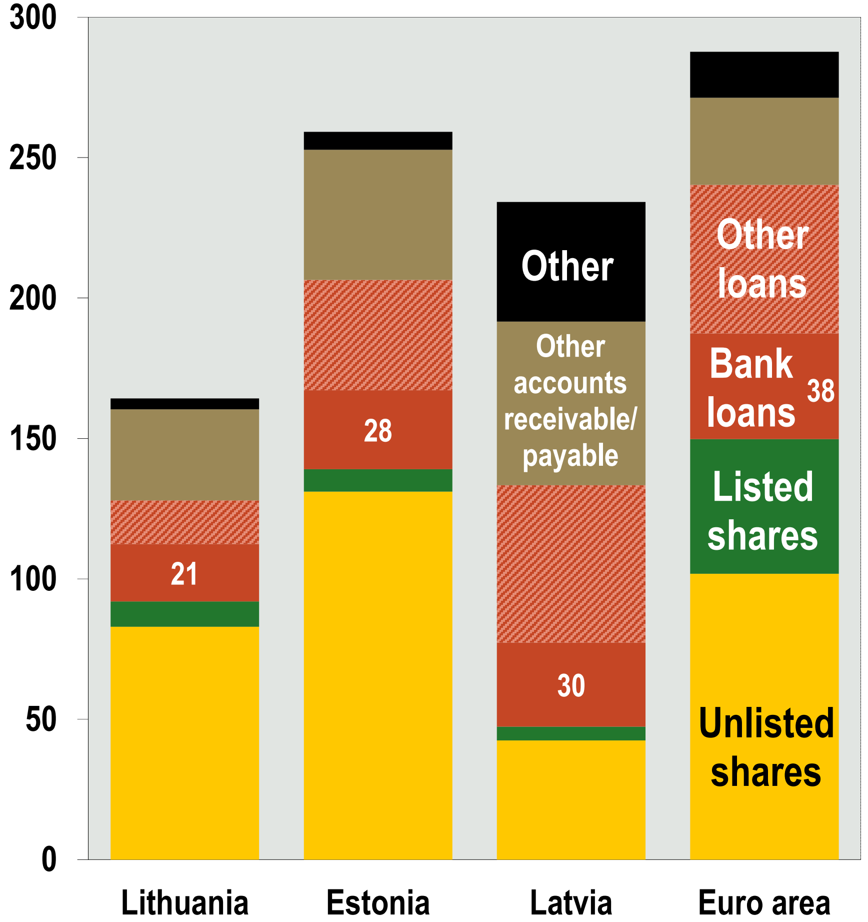
- **Widespread cash use reduces bank deposits**
- **Reliance on (or abuse of) trade credit**
- **Services to non-residents, as in Latvia, Luxembourg, Malta**

Why are the sizes of financial sectors different?

- **Nature of non-financial clients**
  - distribution of firms by size, small vs. large firms
  - aggregate size of non-financial firms – influences maximum firm borrowing capacity and bank lending opportunities
  - availability and use of (cross-border) intra-group funding (e.g. FDI loans)
- **Financial regulation**
- **Availability of state guarantee/financing schemes for SMEs**
- **Other factors …**

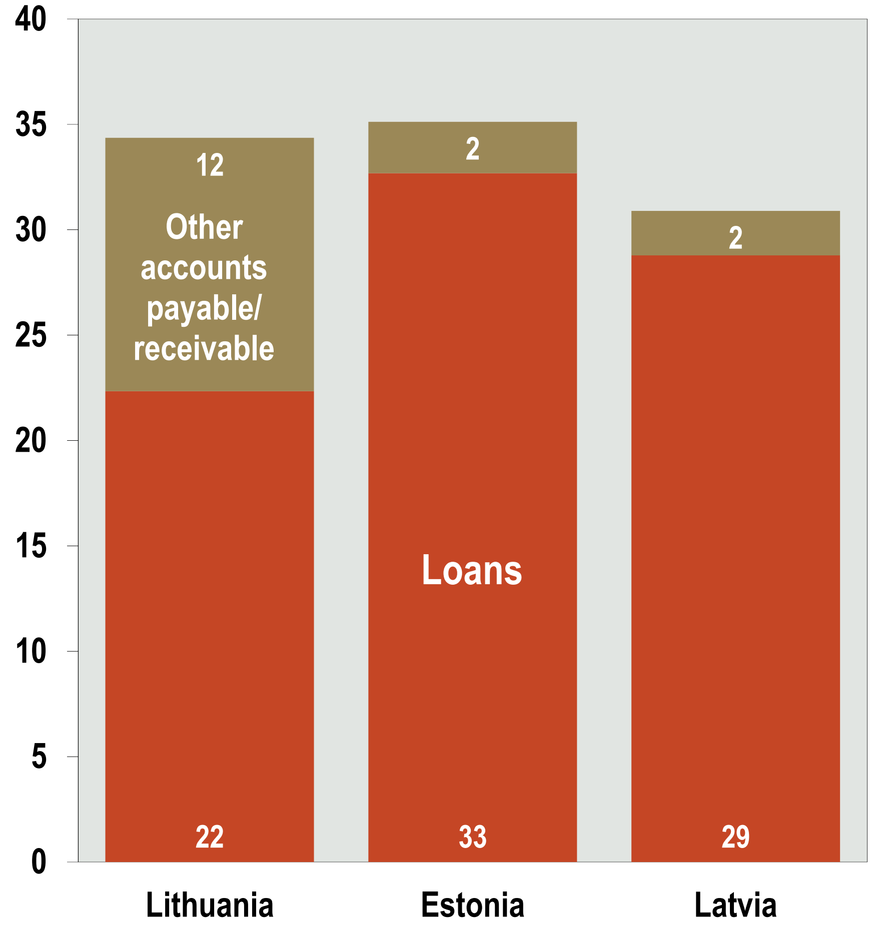
Liabilities of non-financials and households

Liabilities of non-financial corporations, % of GDP



Sources: ECB, Eurostat and Financial accounts of Estonia, Latvia and Lithuania.

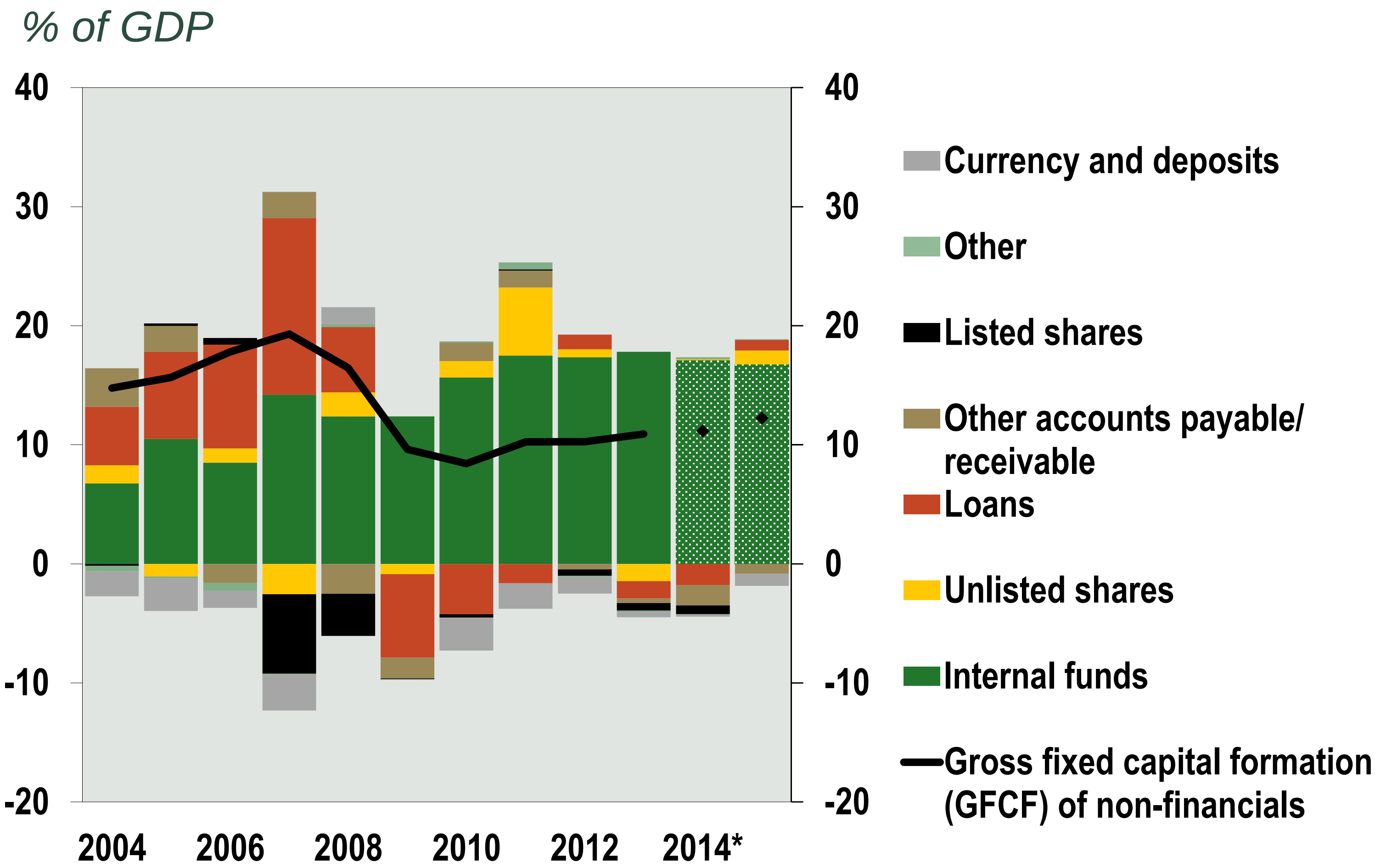
Liabilities of households, % of GDP



Sources: Eurostat, Financial accounts of Estonia, Latvia and Lithuania.

Financing sources: internal funds and net acquisition of financial liabilities

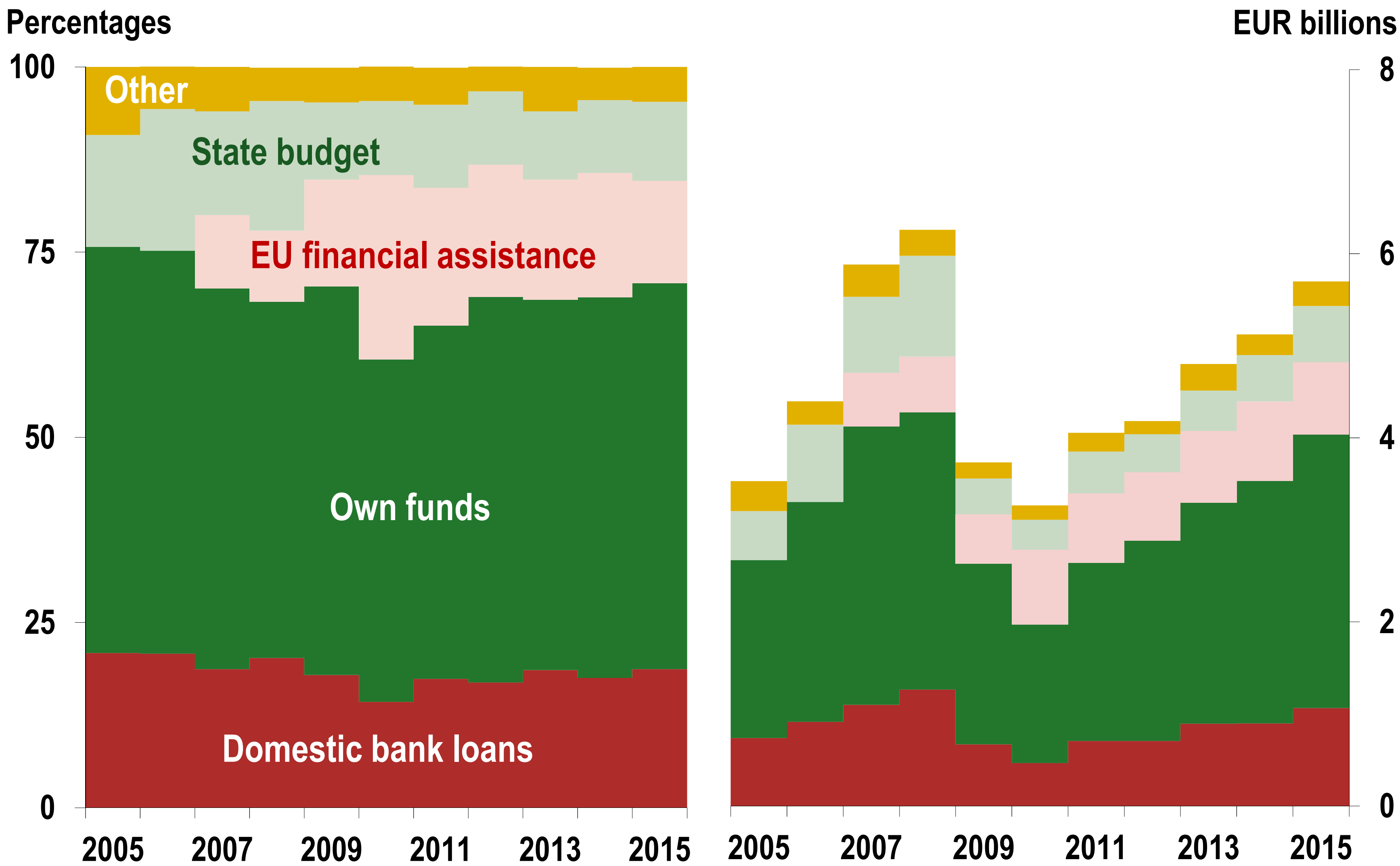
- Internal funds is the main and least volatile source of financing
- External financing seems to be more volatile and procyclical



** Since internal funds and GFCF data for years 2014 and 2015 is not yet available, it is replaced with 2013 observations.*

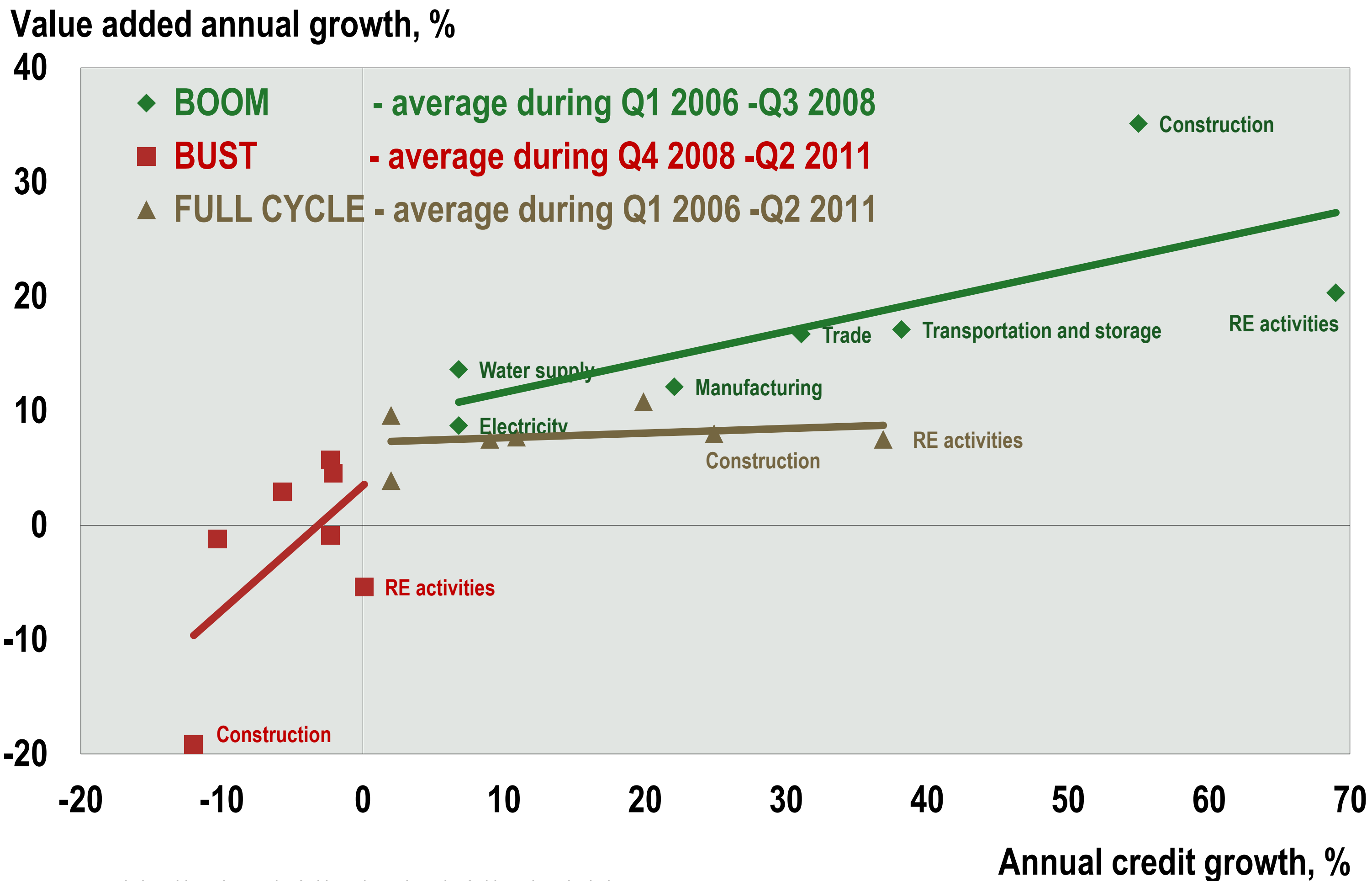
Sources: Statistics Lithuania and Financial accounts of Lithuania.

Financing of investments into tangible assets



Sources: Statistics Lithuania and Bank of Lithuania calculations.

Credit allocation: procyclicality and bias towards real estate-related lending



Sources: Statistics Lithuania. Bank of Lithuania and Bank of Lithuania calculations.

- Mortgages and RE-related lending account for 56% of bank loans to private sector at end-2015
- Lending exhibits RE collateral bias, also due to preferential treatment in Basel regulations

Financial sector effectiveness

- **Credit impact on GDP**

- **Credit allocation decisions**

  Do banks lend to sectors that

  – will grow faster and/or will be able to repay in the future? or
  – lend procyclically to sectors that currently grow faster?

- **Volatility/procyclicality of credit and other forms of external financing**

  – to what extent external financing provided by financial intermediaries can be a diversifier for internal cash flow generation?

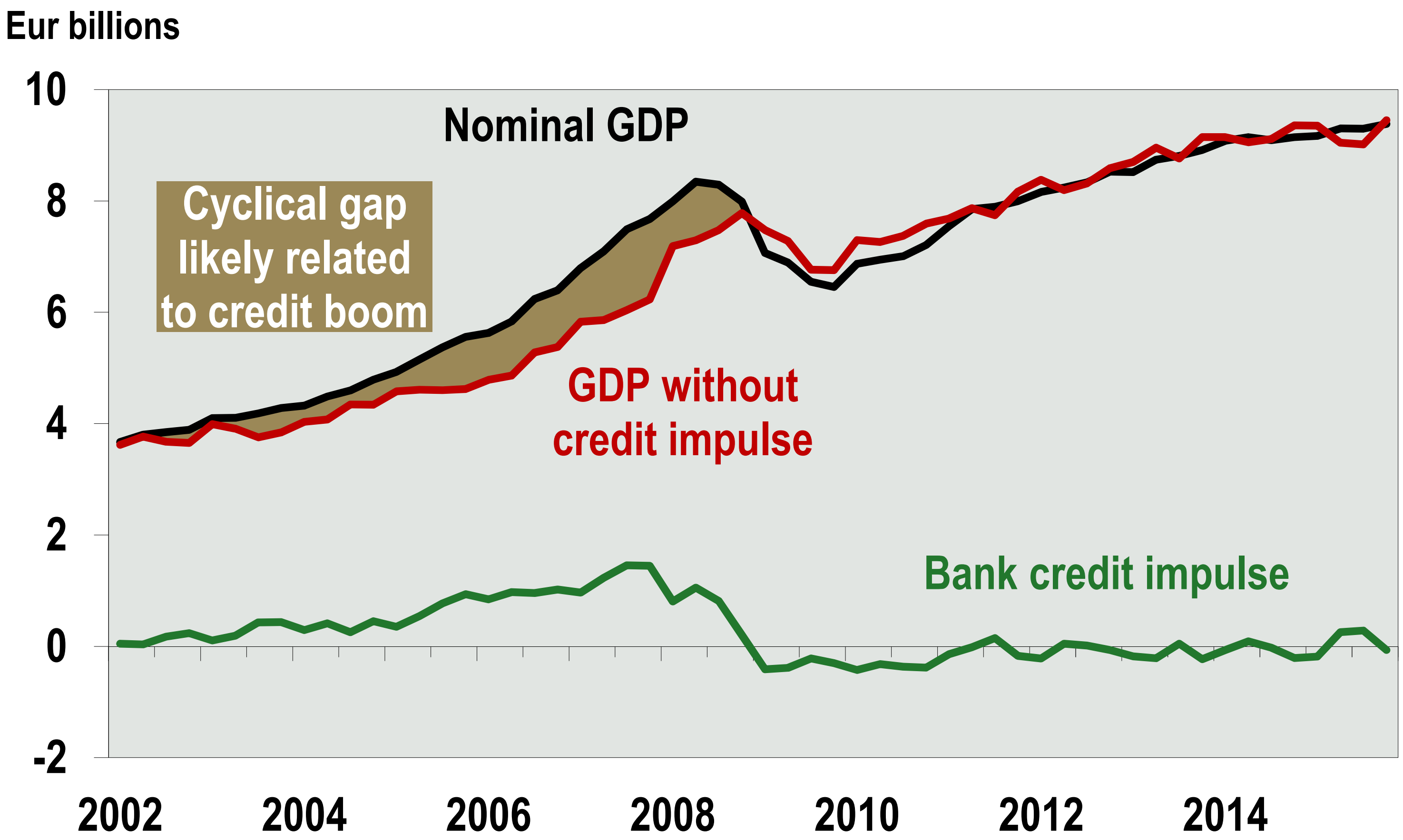
Credit impulse

- Credit creates new spending power for
  - consumption
  - investment: financial or new/existing non-financial assets
- Credit impulse impact on GDP:

Year	Credit flow	Contribution to nominal GDP
1	0	0
2	100	100
3	120	20
4	50	-70

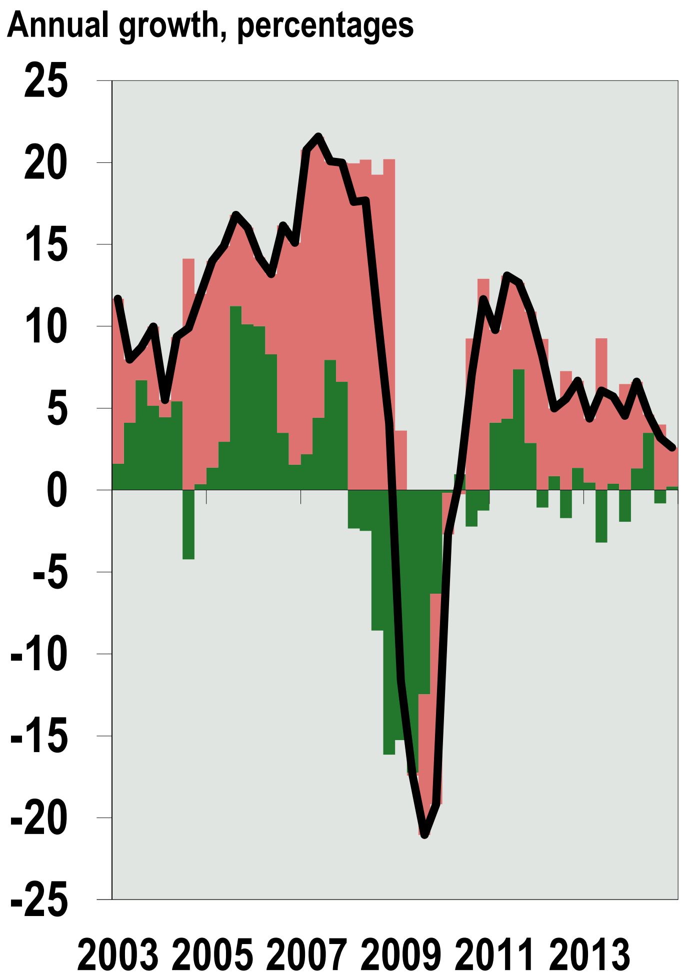
- Credit impulse = Δ credit flow $\approx \Delta$ (Δ credit stock)

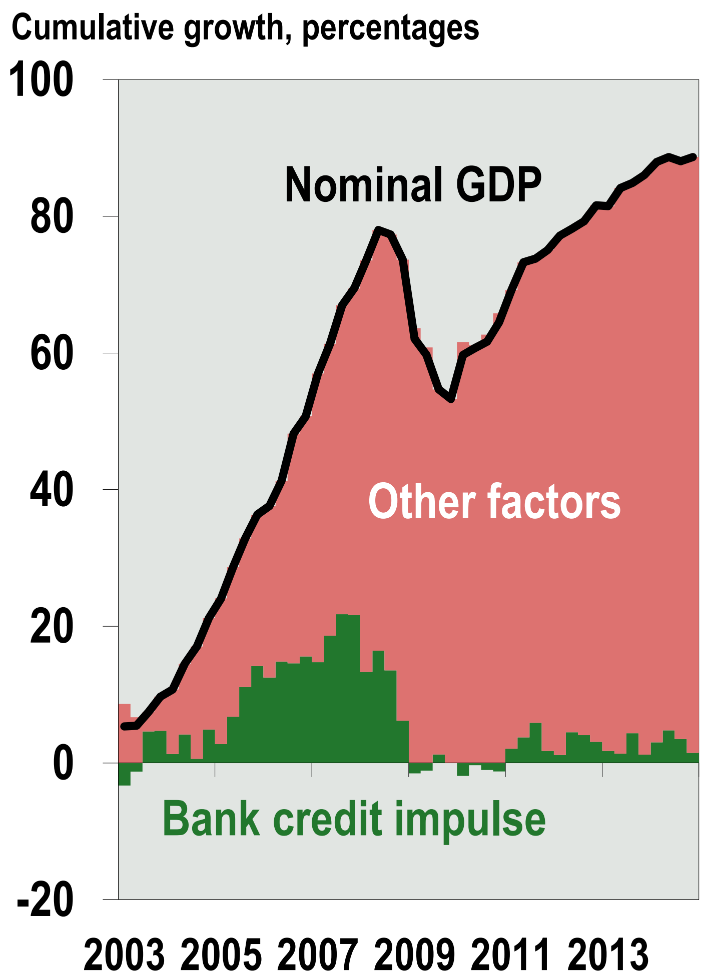
Credit impulse in Lithuania



Source: adapted from T. Ramanauskas et al., "Kreditavimą lemiantys veiksniai ir jo sąryšiai su ekonominiais procesais", Monetary Studies, 2015.

Credit impulse in Lithuania





Conclusions/ suggested takeaways

- Financial sector size is not everything …
- … there may be good reasons why the financial sector in Lithuania is not as large as in Latvia and Estonia
  - Aggregate size and demand for credit by non-financial firms
- … but the financial sector may still be quite effective and sufficient for economy needs
- New credit and external financing more generally contribute to GDP growth
  - It is difficult, however, but nevertheless important to separate bad credit during boom times from good credit for productive investment and use macroprudential instruments to tame the latter